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The Pros and Cons of Shared Appreciation Mortgages

Buyers must balance lower monthly mortgage payments versus lower profits at the sale of property.

By Benny L. KassUSLaw.com Columnist

Mortgage lenders are always looking for new and creative mortgage loan packages. One such mortgage--although not new--is called a Shared Appreciation Mortgage (SAM).

SAMs first surfaced in the 1970's and 1980's, but basically disappeared due to lack of consumer interest. Now, it appears that some major lenders are attempting to revive interest in this kind of loan program.

How SAMs Work

With a SAM, your lender will offer you a below-market interest rate in exchange for an agreement on your part to share between 30 and 60 percent of any appreciation, if and when you sell your house.

Let's look at an example: currently, mortgage rates are hovering around 8 percent. You want to purchase a condominium for \$150,000, and put down 5 percent, or \$7,500. You will need a mortgage of \$142,500.

If you can get a mortgage loan at 8 percent, your monthly payments, based on a 30 year amortization, will be \$1045.63. However, a SAM lender may be willing to give you a loan at an interest rate of 6.5 percent, and the mortgage payments would only be \$900.71 per month. Those lenders who are prepared to offer you a SAM loan are betting that you will be willing to give them up to 60 percent of any profit on the sale of your apartment so that you can save \$144.92 per month, or \$1739.04 per year.

SAM or SCAM?

A SAM may be good for the mortgage industry. But is a SAM good for the homebuyer, or is it really only a SCAM?

Obviously, no one can predict the future of real estate. Historically, although not as volatile as the stock market, real estate prices have fluctuated. The borrower with a SAM

on a house that is depreciating in value will clearly be better off than the borrower on a house that has appreciated substantially. However, buyers always expect appreciation, and certainly would not purchase a house if they knew in advance that the house would go down in value.

Let's go back to our example. If the \$150,000 condominium increased by 5 percent per year, in five years it would be worth approximately \$190,000. This is a \$40,000 gain.

With a SAM mortgage, our buyer would have to part with up to \$24,000 (assuming a 60 percent sharing arrangement) when the property is sold, versus a savings over five years of \$8695.20 in lower monthly payments. In my book, that's a lot of money to give up. This becomes especially important if our buyer wanted to move up to another property five years from now. If his/her condominium unit increased in value over the past five years, it is logical to assume that other real estate similarly increased. Thus, our buyer would have \$24,000 less to use as the down payment for the more expensive replacement property.

Clearly, if the condominium unit in our example decreased in value, this would have been a good deal for our buyer. But as indicated earlier, no one buys real estate expecting to take a loss.

I am not unalterably opposed to a SAM mortgage. The purpose of this column is to put potential borrowers on notice of the pros and cons of such a loan, and to encourage you to do your homework, shop around and determine if there are alternative types of loans available which would not require parting of some portion of the profit.

Negatives of the SAM

Here are some of the negative aspects of a SAM loan:

1. If the property increases in value, you will have to share some of that appreciation with the mortgage lender.
2. What are the tax aspects of such a loan? Will you have to pay income tax on the gain, even though you have to give part of it to your lender? Will you be able to deduct all of the mortgage interest, even though you are - in effect - not the sole owner of the property? These questions, to the best of my knowledge, have not been addressed by the IRS.
3. If you die, will your estate have to share the appreciation with the lender?
4. If you refinance your SAM loan, and obtain a conventional mortgage, you will still have to share the appreciation with the lender? But how does that work? Who makes the determination of the value of the property at the time of the refinance? Keep in mind that if, in our example, you have to give the SAM lender \$24,000 on a refinance, that means that you will be paying your new lender interest on money which you will not really receive.

Perhaps, our potential condominium buyer could obtain the same low-interest mortgage rate by taking out a one-year ARM. While it is true that the loan will probably increase at the end of the first year, our buyer may also be getting a raise from his employer after one year, and could afford the higher mortgage payments. Keep in mind that there are significant income tax deductions for mortgage interest payments, and these deductions should be plugged into your calculations of what you can afford.

It appears that the SAMs are attempting to come back into the mortgage marketplace. Keep your eyes wide open and make sure that this is really in your best interest.

Benny L. Kass is a real estate lawyer in Washington, D.C. and Maryland, and a member of the USLaw.com Affiliate Network.

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